

# **Chapter 2 – Standards of Conduct and Fraud, Waste, and Abuse**

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## **References**

- (a) 5 CFR 2635, Standards of Ethical Conduct for Employees of the Executive Branch
- (b) DoD 5500.7-R, DoD Joint Ethics Regulations
- (c) 41 USC 423, Office of Federal Procurement Policy Act
- (d) PL 104-106, Amended Procurement Integrity Act
- (e) Federal Acquisition Regulations (FAR)
- (f) 18 USC 207, Restrictions on former officers, employees, and elected officials of the executive and legislative branches
- (g) 5 CFR 2641, Post-employment conflict of interest restrictions
- (h) DoD Directive 5500.07, DoD Standards of Conduct
- (i) NAVSEAINST 5041.1, DoD Hotline Program Policy and Procedures for NAVSEA
- (j) DoD Directive 7050.5, Coordination of Remedies for Fraud and Corruption Related to Procurement Activities
- (k) SECNAVINST 5430.92B, Assignment of Responsibilities to Counteract Acquisition Fraud, Waste, and Related Improprieties within the Department of the Navy
- (l) 31 USC 3729, Civil False Claims Act
- (m) 31 USC 3801-3812, Program Fraud Civil Remedies Act
- (n) 41 USC 604, Contract Disputes Act
- (o) 18 USC 874, Anti-Kickback Act of 1986
- (p) 41 USC 605, Decision by contracting officer
- (q) 10 USC 2408, Prohibition on Persons Convicted of Defense Contract-Related Felonies and Related Criminal Penalty on Defense Contractors
- (r) 10 USC 2324, Allowable Costs Under Defense Contracts

# Chapter 2 – Standards of Conduct and Fraud, Waste, and Abuse

## 2.1 Introduction

Considering the significant power vested in Government officials, the public should expect the conduct of such officials to conform to the highest ethical standards. Congress has passed numerous ethics laws, and the Executive branch has promulgated Government-wide regulations addressing the standards of ethical conduct expected of Government employees, both military and civilian (see [5 CFR 2635](#), reference (a), Standards of Ethical Conduct for Employees of the Executive Branch **Error! Bookmark not defined.** and [DoD 5500.7-R](#), reference (b), the DoD Joint Ethics Regulations). As required by DoD for its employees, SUPSHIP personnel receive periodic ethics training from their local counsel's office.

In the context of federal procurements, Congress enacted the Office of Federal Procurement Policy Act, [41 USC 423](#), reference (c). This law was amended by [Public Law 104-106](#), reference (d), and is referred to as the Amended Procurement Integrity Act.

## 2.2 Summary of Amended Procurement Integrity Act

[FAR 3.104](#), reference (e), implements section 27 of the Office of Federal Procurement Policy Act ([41 USC 423](#)). The effective date of the new law was 1 January 1997. The amended law focuses on:

- improperly releasing or obtaining source selection information and contractor bid or proposal information (formerly referred to as “proprietary information”)
- employment discussions between agency officials and contractors
- employment by contractors of former Government officials

These items will be discussed in more detail in later sections of this chapter.

The amended law eliminates all requirements for written certifications, e.g., certifications regarding familiarity with act; not being aware of violations; promising to disclose information about possible violations; and continuing obligation not to disclose proprietary and source selection information.

The amended law eliminates the prior prohibition on a “procurement official” soliciting or accepting a gratuity valued at more than \$10 from a “competing contractor” “during the conduct of a procurement.” This restriction was deemed to duplicate other gratuities rules, such as the prohibition in the Government-wide standards of conduct regarding gifts from prohibited sources in excess of \$20.

Further, the amended law eliminates the requirement for each agency to have a procurement ethics program for training its procurement officials.

## **2.3 Disclosing and Obtaining Procurement Information**

### **2.3.1 Disclosing Procurement Information**

The amended law prohibits certain persons from disclosing certain procurement information, i.e., contractor bid or proposal information or source selection information. This prohibition applies to any person who is:

- a present or former officer or employee of the United States
- any person who is acting or has acted on behalf of the United States
- anyone who has advised the United States with respect to a federal agency procurement and who, by virtue of his office, employment, or relationship, has access to bid, proposal, or source selection information

Such persons must not knowingly disclose such information before the award of the procurement to which the information relates. This section applies only to procurements using competitive procedures. The amended law provides for criminal penalties, including fines and imprisonment for up to five years, if the disclosure was made in exchange for money or to give anyone a competitive advantage.

Definitions relative to this prohibition, “source selection and proprietary information,” are essentially the same terms as prior to amending of the law. The term “contractor bid or proposal information” encompasses proprietary information.

### **2.3.2 Obtaining Procurement Information**

The amended law also prohibits anyone from knowingly obtaining the procurement information described above. Specifically, no one will knowingly obtain such information before award. Mere solicitation of procurement information does not violate the amended law. The same criminal penalties apply to knowingly obtaining procurement information.

## **2.4 Actions Required Regarding Offers of Non-Federal Employment**

If an agency official who is participating personally and substantially in a competitive procurement in excess of \$100,000 contacts or is contacted by a bidder or offeror regarding non-federal employment, he or she will give notice and disqualify him or herself from participating in the procurement, unless the possibility of employment is rejected.

The official must report this contact in writing to the immediate supervisor and to the Designated Agency Ethics Official (DAEO), or his designee (local counsel), and either reject

the possibility of employment or disqualify himself/herself from further participation until authorized to resume participation. In contrast to the prior law, the disqualification is immediate.

A written notice of disqualification goes to the Head of the Contracting Activity (HCA) or his/her designee, with concurrent copies to the immediate supervisor, the contracting officer, the Source Selection Authority (SSA), and the local legal office. Copies of these disqualifications must be kept for two years.

FAR states that if an employee participates “personally and substantially” in certain listed procurement-related activities, then he/she will be required to report such contacts and either reject the possibility of employment or disqualify himself/herself. Participating personally and substantially in a federal procurement is defined in [FAR 3.104-1](#). Civil or administrative penalties can be imposed for violations of this prohibition.

## **2.5 Post-Government Employment Restrictions**

The amended law provides for a one year prohibition on receipt of compensation from certain contractors if a former official served in certain capacities or made certain decisions on behalf of the Government. However, the amended law only applies to services provided or decisions made on or after 1 January 1997, the effective date of the amended law.

Individuals who left the Government prior to 1 January 1997 are not covered by the amended law but are subject to the old procurement integrity rules. However, the old procurement integrity rules do not apply to anyone after 31 December 1998.

Under the amended law, a former agency official may not accept compensation from a contractor within a period of one year after such official:

- Served as the Procuring Contracting Officer (PCO), SSA, member of the Source Selection Evaluation Board (SSEB), or the chief of a financial or technical evaluation team. This applies for a procurement in which the contractor was selected for award of a contract in excess of \$10 million.
- Served as the Program Manager, deputy Program Manager, or Administrative Contracting Officer (ACO) for a contract in excess of \$10 million awarded to the contractor.
- Personally made a decision to:
  - Award a contract, subcontract, modification of a contract or subcontract, or a task or delivery order in excess of \$10 million to the contractor
  - Establish overhead or other rates applicable to a contract or contracts for the contractor that are valued in excess of \$10 million

- Approve issuance to the contractor of a contract payment or payments in excess of \$10 million
- Pay or settle a claim with the contractor in excess of \$10 million

Civil or administrative penalties can be imposed on both the former official and the contractor for violations of this prohibition.

A former official is not prohibited from accepting compensation from any division or affiliate of a contractor that does not produce the same or similar products or services as the entity of the contractor that is responsible for the contract. This restriction applies to sole source and competitive contracts in excess of \$10 million.

Under the amended law, as under the old law, the DAEO (counsel) will give a safe harbor (i.e., ethics advisory) opinion to any employee or former employee who wishes to know whether the individual can accept compensation from a particular contractor subsequent to their separation from the Government.

In post-government employment restriction, the term “in excess of \$10 million” means the value of a contract, including the estimated value of the contract at the time of award, and all options.

In addition to the post-employment restrictions mentioned above, a criminal statute in [18 USC section 207](#), reference (f), contains several post-employment restrictions that apply to certain former employees including a basic prohibition for all that “No former employee shall knowingly, with the intent to influence, make any communication to or appearance before an employee of the United States on behalf of any other person in connection with a particular matter involving a specific party or parties in which he participated personally and substantially as an employee and in which the United States is a party or has a direct and substantial interest ([5 CFR 2641.201\(a\)](#), reference (g)). Employees should consult their ethics advisor for advice on specific post-employment restrictions that apply to them.

## **2.6 Determining Violations or Possible Violations**

If the contracting officer receives or obtains information of a violation or possible violation of the law, that officer is required to determine whether it has an impact on the pending award or source selection. If the contracting officer determines that the violation or possible violation impacts the procurement, he/she is to forward this information to the HCA or his/her designee. The HCA who receives information that describes an actual or possible violation will review all relevant information and take appropriate action. The HCA may request information from appropriate parties about the violation. If the HCA determines that the Act has been violated, the HCA may direct the contracting officer to cancel the procurement, disqualify an offeror, or take other appropriate action.

## 2.7 Measures to Minimize Improper Conduct

Supervisory personnel should make the following available to all cognizant personnel: a copy of the [FAR](#), [DoD Directive 5500.07](#) (Standards of Conduct), reference (h), and the [DoD Joint Ethics Regulation](#). Measures should be instituted to minimize prohibited conduct. SUPSHIP personnel must understand that violation of these regulations may result in disciplinary action and that violations of ethics statutes may result in civil and/or criminal penalties.

SUPSHIP should analyze and identify operations with particular potential for misconduct. When warranted, SUPSHIP should develop and execute a plan to minimize that potential misconduct. The following should be considered in formulating such a plan:

- increase surveillance of Government personnel at remote contractor's sites through unscheduled inspections of specific operations by military or civilian supervisors
- reduce tour length of Government personnel at remote sites
- rotate Government personnel among contractor sites
- require that preparation of a specification and inspection or acceptance of work under that specification be performed by different individuals
- audit work authorized on-site for actual completion
- audit accepted work for conformance to specifications
- audit Government Property Administrator's decisions on scrap, repairables, and mandatory returnables
- audit scrap materials sold to contractors by Government property administrators to ensure that materials are scrap
- be alert for signs of affluence not commensurate with the economic status of Government employees
- ensure all SUPSHIP personnel understand the command requirement for absolute adherence to the Standards of Conduct
- be observant for possible falsification of inspection records

## 2.8 Hotline Policies and Procedures for NAVSEA Shore Activities

[NAVSEAINST 5041.1A](#), reference (i), applicable to all NAVSEA shore activities and detachments, encourages employees to use the chain of command in reporting fraud or

relating improprieties. Otherwise, employees are encouraged to use the local Hotline, or NAVSEA, Navy, or DoD Hotlines.

A Hotline may be established at the discretion of the commanding officer. The instruction ensures that Hotline referrals are forwarded to NAVSEA, that complete records and controls are established and maintained, and that examiners are independent, impartial, and free of actual or perceived influence. The instruction gives procedures on publicizing information about Hotline programs and contacting appropriate authorities to respond to fraud or related improprieties.

## **2.9 Fraud, Waste, and Other Abuse**

This section discusses coordination of fraud prevention, indicators of fraud, and actions against fraud.

### **2.9.1 Coordination for Fraud Prevention**

DoD officials are responsible for the integrity of DoD contracts and must be prepared to take immediate action to protect Government integrity and interests when required. Although criminal cases often take years to complete, the DoD can take contractual and administrative actions on less evidence than needed for a criminal conviction. A coordinated approach to criminal, civil, contractual, and administrative actions permits the Government to expedite criminal proceedings. Early action and coordination are essential to ensure that no action taken will adversely affect the Government's ability to pursue any other available action.

The Secretary of Defense (SECDEF) issued [DoD Directive 7050.5](#), reference (j), to ensure establishment of a centralized point of coordination. This directive requires that the cognizant criminal investigative organizations inform the centralized points of coordination each time a significant fraud or corruption investigation in procurement or related activities is opened. Through this process, the Government will be able to use its variety of remedies in a more efficient and effective manner. In 2007, SECNAV established the Acquisition Integrity Office (AIO) to manage acquisition fraud matters within DoN. Per [SECNAVINST 5430.92B](#), reference (k), AIO acts as the centralized organization within DoN to monitor and ensure the coordination of all criminal, civil, administrative, and contractual remedies for all cases, including investigations for fraud, waste, and related improprieties related to acquisition activities affecting the DoN. As the centralized organization for acquisition fraud matters, AIO is the single point-of-contact for all acquisition fraud matters. AIO partners with NCIS and the Naval Audit Service (NAS) to provide investigative support on acquisition fraud cases.

### **2.9.2 Indicators of Defective Pricing Fraud**

Auditors assess pricing situations to determine if the circumstances surrounding any positive defective pricing are indicators of potential fraud. The auditor is responsible for finding and reporting indicators, not proving fraud. The Truth-in-Negotiations Act gives the Government the right to adjust the contract price when the price is based on inaccurate, incomplete, or



out-of-date cost or pricing data. Defective pricing occurs when more current, complete, and accurate data exist, but are not provided to the negotiator.

The Defense Contract Audit Agency (DCAA) is responsible for performing reviews of selected contracts and subcontracts. The agency issues a defective pricing report when the auditor finds that the contract price was increased because the contractor did not follow the Truth-in-Negotiations Act. In the past, auditors concentrated on finding defective pricing and not assessing the reason for defective pricing and indications of fraud. The DCAA issued guidance by providing a list of indicators for assessing whether the situation is a sign of possible fraud that should be referred for investigation. The following are indicators of defective pricing fraud that demonstrate the need for further investigation:

- using a vendor other than the proposed vendor
- intentional failure to update cost or pricing data
- selective disclosure
- changed dates
- lost records
- lack of support for proposal
- change in make-versus-buy
- reporting a production break and increased cost when no actual break occurs
- combining items
- intentionally eliminating support to increase the proposal prices
- including inflated rates in the proposal, for example, for insurance or workers' compensation
- intentionally duplicating costs by proposing them as both direct and indirect
- indication of other fraudulent activities which would include material substitution, used or new, and certifying replacement of parts versus repair
- proposing obsolete items that are not needed
- continually failing to provide requested data
- not disclosing an excess material inventory that can be used in later contracts
- refusing to provide data which is requested for elements of proposed costs

- not disclosing actual data from completed work for follow-on contracts
- knowingly using an inter-company division to perform part of the contract but proposing purchase or vice versa
- ignoring established estimating practices
- suppressing studies that do not support the proposed costs
- commingling work orders to hide productivity improvements
- requesting an economic price adjustment clause when the material is already purchased
- submitting fictitious documents
- withholding information on batch purchases
- failing to disclose internal documents on vendor discounts
- failure of prime contractor to pay subcontractor

### **2.9.3 Actions against Fraudulent Activities**

The Government has the right to insist on certain standards of responsibility and business integrity from its contractors and to take a variety of actions against contractors who engage in fraudulent activities. These actions described below are taken in conjunction with, after, or instead of criminal prosecution.

The Civil False Claims Act, [31 USC 3729](#), reference (l), can make a contractor liable for submission of a false claim to the Government and allows the Government to recover damages and penalties for false claims. The Government must suffer monetary damages to recover damages and must prove by a preponderance of evidence that the contractor knowingly submitted a false claim.

The Program Fraud Civil Remedies Act, [31 USC 3801-3812](#) (as amended by [Public Law 110-69](#)), reference (m), allows Federal agencies to impose administrative penalties for certain false claims and statements.

The Contract Disputes Act, [41 USC 604](#), reference (n), makes a contractor liable for the amount of any unsupported part of a claim plus the costs of reviewing the claim if it is determined that it is a result of misrepresentation of fact or fraud.

The courts can order the forfeiture of the entire amount of a claim in which it judges the proof is based on contractor fraud or attempted fraud. A contractor risks losing the entire claim even if the claim is only partially based on fraud.

The contracting office has the right to terminate a contract for default because of a contractor's failure to perform. The Government also has the right to terminate a contract for default for other improper conduct, including violation of the Anti-Gratuities Clause ([FAR 52.203-3](#)) and [41 USC 51- 58](#), the Anti-Kickback Act of 1986, reference (o), which prohibits gifts by a subcontractor as inducement for award of the contract.

Rescission is a common law remedy in contracts which allows both parties to return to their position before the contract. This remedy may be used when fraud or corruption occurs in obtaining or awarding the contract. The Government may administratively rescind a contract when there has been a final conviction for bribery, gratuities, or conflicts of interest.

According to [41 USC 605](#), reference (p), contracting officials do not have the authority to pay claims where there is reasonable suspicion of fraud. Contracting officials should not take further action without coordination with the Department of Justice. The provisions of [FAR 9.1](#) state that contracts may only be awarded to responsible contractors. Contractors must affirmatively demonstrate their responsibility, including a satisfactory record of integrity and business ethics.

By provisions of [FAR 9.4](#), contractors may be prohibited from doing business with the Government for the commission of fraud. Suspension is an interim measure; a contractor may be suspended for up to 18 months while the investigation is underway. Debarment is a final determination of a contractor's non-responsibility and may be effective for up to three years. A contracting officer can recommend the debarment of companies and individuals and can impute, in recommending its debarment, the conduct of certain key individuals in that company. Contracting officials must forward reports of improper contractor activity to the suspension and debarment authority at the earliest opportunity to make suspension or debarment effective.

Under [FAR 31.205-47](#), contractors who are found to have engaged in fraud on cost-type contracts are not entitled to recover legal and administrative costs incurred in unsuccessfully defending against Government action.

[10 USC 2408](#), reference (q), provides guidelines on "Prohibition on Persons Convicted of Defense Contract-Related Felonies and Related Criminal Penalty on Defense Contractors". Among other things, the statute bars an individual convicted of fraud or any other felony arising from a contract with the DoD from working in management or a supervisory capacity on any defense contract.

Under [10 USC 2324](#), reference (r), a contractual penalty can be assessed when a contractor submits a claim for a direct or indirect cost when such a cost is specifically ruled unallowable by either statute or regulation. The statute also authorizes a penalty for the knowing submission of defective cost or pricing data.

#### **2.9.4 Government Personnel**

The Government has a variety of remedial actions to take against employees who collude with contractors in fraudulent conduct, including: termination, revocation of a contracting officer's warrant, recoupment of lost funds, and administrative penalties for conflicts of interest.